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SUBJECT: ECONOMIC TOUR D'HORIZON WITH HONDURAN MINISTER OF
THE PRESIDENCY LUIS COSENZA

Classified By: AMBASSADOR LARRY PALMER; REASONS 1.5 (B) AND (D)

SUMMARY

11. (C) In a March 12 call on Honduran Minister of the Presidency Luis Cosenza, DCM and Econcouns discussed the top economic items on the bilateral agenda. Cosenza committed to campaigning for the repeal of the teacher and nurse "estatutos" that have caused the rapid increase in government expenditures over the past five years (and impeded the attainment of an IMF program this year). He expressed interest in the Millenium Challenge Account, and in ways to include incentives for new foreign investment in the Central America Free Trade Agreement (CAFTA) negotiations. DCM urged rapid ratification of the ICC Article 98 Agreement and two OAS counter-terrorism conventions, and a raft of important economic legislation. Both sides agreed on the importance of improvement to port security, Honduras' investment climate and the rule of law. End Summary.

Bilateral and Regional Relationships

12. (C) DCM expressed USG satisfaction with the March 11 suspension by the Nicaraguan Congress of the 35 percent retaliatory tariff and appreciation for Honduran restraint over the past three years, indicating that the USG had been quietly urging this move in the interest of integration. Cosenza attributed much of the credit to Nicaraguan President Bolanos. Asked if he thought that the Honduran Congress would proceed with the enactment of sanctions (and immediate suspension) as some in the business community were urging, Cosenza shook his head no. He indicated that President Maduro was advising against such a move; if the Nicaraguan tariff were reinstated, the Honduran Congress could easily enact countermeasures at that time.

13. (C) Cosenza indicated that President Maduro will try to meet with the IMF, World Bank and IDB on the margins of the April 11 meeting of the Central American Presidents with President Bush on CAFTA. He asked for suggestions on other meetings.

Negotiations with the IMF

14. (C) Asked about the status of fiscal measures needed to reach agreement with the IMF on a new Poverty Reduction and Growth Facility program, Cosenza replied that the package of tax measures was ready and will be submitted in early April, between the President's trips to Italy (which may now be off) and Washington. Emboffs complimented him on his clear presentation on the need to repeal the wage and benefits provisions of the special laws (called "estatutos") governing teacher and medical worker pay. Cosenza confirmed that the GOH had concluded that this was absolutely necessary to regain control over government finances and reach agreement with the IMF, and had decided to fight as hard as possible to attain this goal. He noted that the move could come within the next week; the GOH is currently discussing which estatuto will be first. Comment: The government may be working with the Supreme Court to have the estatutos found unconstitutional. This would allow them to avoid the difficult task of building the needed consensus for repeal of the laws in the Congress. End Comment.

15. (C) Econcouns provided Cosenza with a copy of the Embassy's March 10 notification to the Minister of Finance, per instructions from Washington, that lack of payment of USD 12,000 on July 15 or USD 1.7 million on September 3 for debt service on Department of Defense loans could trigger a cessation of new USG foreign assistance under the Brooke Amendment. The looming debt service payment deadline was one more important driver for reaching an agreement with the IMF that would put the GOH back on the road to HIPC debt relief.

Millennium Challenge Account

16. (C) DCM provided Cosenza with a copy of the fact sheet on the Millennium Challenge Account program and outlined the currently envisaged system of qualifying for MCA eligibility and emphasized the importance of paying special attention to measures that might help the GOH meet the good governance criteria. Cosenza expressed his appreciation for the background on the program and indicated that the eligibility criteria are all important issues that the GOH is already working to address for the sake of the country's own well-being. He requested a list of the countries that are likely to be considered for eligibility during the first year of the program, in order to start getting an idea of how Honduras compares to its low-income peers.

Agriculture Issues

17. (C) DCM noted that there would be a decision on Honduras's request for wheat under the Food for Progress Program shortly. If Honduras is approved, it will be important for the Ministry of Agriculture (SAG) and USDA to work closely on a agreement on the use of the local currency proceeds from the sale of the wheat. Cosenza asked if the funds could be used for low-income housing. Econcouns explained that they are more commonly used for agricultural projects. She took the opportunity to emphasize the importance of completion of the last major USDA-SAG project, the transfer of the mango hot-water treatment plant in Comayagua to an association of mango producers. She explained that the legislation creating this association had been stalled in Congress and that Emboffs had been talking to the Minister of Agriculture about the importance of completion of the transfer. Cosenza promised to look into it.

CAFTA

18. (C) Econcouns gave an overview of the current status of the Central American Free Trade Agreement negotiations and asked about GOH plans to build up the permanent, technical trade policy staff. Cosenza said that the GOH is supporting Minister of Industry and Trade Norman Garcia's efforts to hire and train negotiators and reiterated his strong belief that the only way to keep well-trained negotiators after a change in administration would be to create a non-political public-private institute. He discounted the possibility that Congressional approval of a Civil Service law would prevent large-scale turnover in government agencies after the next election; Cosenza acknowledged that the law would be an important step, but emphasized that it would take time to change the political culture.

19. (C) Econcouns noted that there would be sensitivities on agriculture on both sides, but that the two countries could work together in the WTO toward the goal of reducing trade distorting subsidies without affecting the USG's ability to implement food aid and agricultural credit programs that are available to countries like Honduras. She confirmed that the Embassy is working closely with the Trade Ministry to identify areas in which cooperation in the WTO negotiations would be particularly helpful, such as the TRIPS moratorium, the agriculture negotiations and the services talks.

110. (C) Econcouns also mentioned that during the course of the negotiations, the USG will be warning the Central Americans that some issues can not bend because of their importance to gaining U.S. congressional ratification for an eventual CAFTA, such as compliance with labor and environment language in the Trade Promotion Authority legislation. The GOH can expect that some of the trade rule chapters may require changes to Honduran legislation.

111. (C) Cosenza asked about the possibility of including in the CAFTA a provision allowing U.S. investors to deduct income taxes paid in Honduras from their U.S. tax returns (thus allowing the GOH to start levying income tax on these maquila companies). Econcouns explained that the Treasury Department is the key contact for discussion of a prospective Double Taxation treaty. The GOH could forward a request directly to Treasury (and she had provided this information to the Ministry of Finance previously). She also explained that in considering these requests, Treasury places priority on those countries that the U.S. private sector has identified as important. As far as the elimination of the Honduran income tax exemptions for companies located in free zones, Econcouns noted that it was generally the Honduran-owned maquila companies (comprising about 40-50 percent of the textile and apparel firms in Honduras) that have pushed for maintenance of these tax incentives.

Investment incentives will be an important topic of negotiation in the CAFTA talks. Cosenza then backtracked and expressed the GOH's view that continued maintenance of the free zones would be important to keeping the textile and apparel industry in Central America.

¶12. (C) Cosenza also asked about the possibility of the inclusion of tax incentives by the USG for U.S. companies to invest in Honduras and other Central American companies, along the lines of incentives provided for Puerto Rico (an apparent reference to Section 936 exemptions from federal taxes for Puerto Rican based subsidiaries of U.S. companies).

He talked at length about the importance of a CAFTA agreement that promotes additional investment so that it does not just represent at the end another broken dream.

Econcouns countered that U.S. companies who critique the investment climate in Honduras never mention the need for tax incentives - instead they point to issues such as the high cost telecommunications and energy, the weak judicial system, crime, and regulatory and administrative delays. Cosenza was adamant that the GOH will be seeking some type of foreign investment incentive program from the USG in the context of the CAFTA negotiations.

Investment Climate, Commercial Disputes and Needed Legislation

¶13. (C) Continuing the discussion on needed improvements in the investment climate, DCM commented on the impressive presentation made by Vice President Vicente Williams on March 11 during the rollout of the Competitiveness Council's workplan. An important element affecting the investment climate is the relatively weak judiciary. The DCM thanked Cosenza for the government and Supreme Court's help in pushing for resolution of outstanding commercial disputes. Post saw a number of cases resolved in late 2002, although there had been significant backsliding in three of the cases in early 2003. The DCM also emphasized that no progress had been made to date in arbitration of outstanding Amcit land disputes involving the Honduran government or municipalities.

Econcouns reminded Cosenza that the GOH had adopted a law allowing the state to engage in arbitration in selected cases during a short window of six months. As the law went into effect on January 16, there are only approximately four months left to make offers to the Amcit claimants. Cosenza indicated that he would look into the issue.

¶14. (C) The DCM mentioned pending legislation that we see as important. On the economic side, these include passage of the civil service reform law, a civil aviation law, restructuring of the telecommunications and power sectors, creation of a unified land registry, and the legislation creating the mango plant association. On the political side, the DCM emphasized the critical importance of ratification of ICC Article 98 Agreement and two pending OAS conventions on counter-terrorism.

Port Security

¶15. (C) Emboffs also emphasized the importance of vastly improved port security, in the post September 11 environment.

They urged Cosenza to ensure that the GOH prepares the country's ports over the next year to meet new legislation for maritime traffic to the U.S., even if this requires partial or total concession of port operation and security functions. Cosenza responded that the GOH is fully committed to doing so, and in fact do hope to concession Puerto Cortes during this administration. The Customs Service is currently working on the purchase of container X-ray equipment that will be used to scan both incoming and outgoing containers. He took on board Emboffs comments about the importance of also strengthening port perimeter security and creation of an independent security force.

Roatan

¶16. (C) Econcouns summarized the diverse problems that Post is seeing on the island of Roatan, including egregious land disputes, lack of arrests in Amcit murder cases, drug trafficking, flouting of U.S. fishing laws, and lack of environmental enforcement. She acknowledged that the rule of law has traditionally been weak in the Bay Islands but explained that the treatment of Amcits in Roatan is becoming intolerable; Cosenza indicated that he concurred. She explained that there had been no progress to date in the Moore land case and at the same time, she noted, the islanders are benefiting from U.S. dollars in a variety of ways - tourism, real estate tax revenues, fishery exports to the U.S. and dockings by U.S. Navy and Coast Guard vessels.

17. (C) Cosenza, fairly frankly, discussed the wide-ranging challenges they faced in improving the rule of law in the islands. He noted that the USG perhaps has the strongest leverage of all, such as our ability to deny or revoke visas for presumption of illegal activity and capacity to invoke sanctions for violations of U.S. laws such as the TEDS/shrimp decertification. Cosenza indicated that the GOH would understand if the USG takes targeted moves, and asked only that we not harm the reputation of the country or cut off U.S. tourism. DCM noted that we will stay in close touch on these issues.

18. (C) Comment: The discussion was cordial and relaxed, and provided a good opportunity to ensure that President's top staff is aware of the top economic issues on the USG's agenda. Cosenza appeared sincerely intent on tackling the estatutos, one of the major reasons for the GOH's structural and growing budget deficit. Although he had received briefing material on the Millennium Challenge Account from the Honduran Ambassador in Washington, he appreciated the opportunity to discuss the envisioned process in greater detail. The discussion also gave Emboffs an opportunity to focus on the Honduran need to make stronger efforts on good governance and anti-corruption. The GOH, if found eligible, can be expected to make MCA proposals for large infrastructure projects and funding of low-income housing. Cosenza also seemed sincerely interested in improving port security in order to assure Puerto Cortes' continued importance for shipping between the U.S. and the isthmus.

19. (C) Comment continued: Cosenza's push for USG incentives for companies investing in Central America reflects the lack of understanding in the Honduran government of U.S. trade policy and sensitivities in the U.S. about claims that trade agreements lead to an export of jobs. In the discussions about the investment climate and Roatan, he expressed the GOH's frustration with their inability to make more rapid progress in changing the status quo. Embassy will continue to urge the GOH to focus on the details of the CAFTA negotiations, including the trade capacity building discussions, and to move on reforms that will improve the investment climate in Honduras (including moving on long standing investment and commercial disputes). We will also continue to encourage the Hondurans to be more active in support of our mutual interests in the FTAA and WTO negotiations. End Comment.
Palmer